Notice of Motion for a Protective Order

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

67 Civ. 60

ROSALIND FOGEL and GERALD FOGEL,

Plaintiffs,

—against—

GEORGE A. CHESTNUTT, JR., JOHN CURRIER, FRANK G. FOWLER, JR., WARREN K. GREENE, RICHARD W. RADCLIFFE, STANLEY L. SABEL, ELIZABETH SULLIVAN, FRANCIS L. VEEDER, AMERICAN INVESTORS CORPORATION, CHESTNUTT CORPORATION, THE FUND OF FUNDS, LTD., I.O.S., LTD. (S.A.), JESUP & LAMONT and AMERICAN INVESTORS FUND, INC.,

Defendants.

SIRS:

PLEASE TAKE NOTICE that upon the annexed affidavit of John F. Newton sworn to the 15th day of February 1967, and upon the notice to take deposition upon oral examination of defendant George A. Chestnutt, Jr. dated the 30th day of January 1967 and upon the complaint, copies of which are hereto annexed, and upon all the proceedings heretofore had in this action, defendant American Investors

Notice of Motion for a Protective Order

Fund, Inc. by its undersigned attorneys will move this Court at Room 506, United States Courthouse, Foley Square, Borough of Manhattan, City and State of New York, on the 23rd day of February, 1967, at 10:00 o'clock in the forenoon, or as soon thereafter as counsel may be heard, for a protective order pursuant to Rule 30(b) of the Federal Rules of Civil Procedure conditioning defendant Chestnutt's examination before trial and all further proceedings herein relating to non-federal claims upon plaintiffs first posting $100,000 security for the reasonable expenses including attorneys' fees, which may be incurred by defendant American Investors Fund, Inc. in connection with the above entitled action and by the other parties defendant in connection therewith for which American Investors Fund, Inc. may become subject pursuant to Section 627 of the Business Corporation Law, to which security American Investors Fund, Inc. shall have recourse in such amount as the Court shall determine upon the termination of the action and further requiring plaintiffs to serve a written notice of the giving of said security upon American Investors Fund, Inc.'s attorneys and staying all other proceedings on the part of plaintiffs except to review or vacate said order until compliance with such order, or, in the alternative, dismissing alleged "pendent" state law claims for want of jurisdiction or as a matter of discretion, and for such other, further and different relief as to the Court may seem just and proper.

Notice of Motion for a Protective Order

Dated: New York, N. Y.
February 15, 1967

Yours, etc.

O'Connor & Farber

By /s/ Clendon H. Lee
A Member of the Firm
Attorneys for Defendant
American Investors Fund, Inc.
Office and Post Office Address
120 Broadway
New York, New York 10005
Telephone # RE 2-5800

To:

Pomerantz Levy Haudek & Block, Esqs.
Attorneys for Plaintiffs
Office and Post Office Address
295 Madison Avenue
New York, New York 10017

Carro, Spanbock & Londin, Esqs.
Attorneys for Jesup Lamont
10 East 40th Street
New York, New York 10016

Willkie, Farr, Gallagher,
Walton & Fitzgibbon, Esqs.
Attorneys for Defendant
I.O.S., Ltd. (S.A.), et al.
1 Chase Manhattan Plaza
New York, New York 10005

Affidavit of John F. Newton Sworn to February 15, 1967 in Support of Motion

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

67 Civ. 60

ROSALIND FOGEL and GERALD FOGEL,

Plaintiffs,

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GEORGE A. CHESTNUTT, JR., JOHN CURRIER, FRANK G. FOWLER, JR., WARREN K. GREENE, RICHARD W. RADCLIFFE, STANLEY L. SABEL, ELIZABETH SULLIVAN, FRANCIS L. VEEDER, AMERICAN INVESTORS CORPORATION, CHESTNUTT CORPORATION, THE FUND OF FUNDS, LTD., I.O.S., LTD. (S.A.), JESUP & LAMONT and AMERICAN INVESTORS FUND, INC.,

Defendants.

STATE OF NEW YORK,
COUNTY OF NEW YORK, *ss.:*

JOHN F. NEWTON, being duly sworn, deposes and says:

1. I am Treasurer of defendant American Investors Fund, Inc. ("the Fund"), a New York corporation. Plaintiffs have brought a "derivative" stockholders action against the Fund and the other defendants named in the complaint. This affidavit is submitted in support of the Fund's motion for a protective order conditioning all further proceedings herein including oral examinations before trial upon plain-

tiffs' first posting security for expenses in the initial amount of $100,000 in accordance with §627 of the New York Business Corporation Law, or in the alternative dismissing the state claims.

2. I am advised by the transfer agent of the Fund, The Bank of New York, that the plaintiffs are the record owners of approximately 50 shares of stock in the Fund standing in their names at an address in Brooklyn, New York. The complaint alleges that they bring this action "derivatively on behalf of the Fund." All of the directors of the Fund are named as defendants, including a former director. Other defendants include the investment adviser to the Fund, Chestnutt Corporation (as well as its dissolved predecessor American Investors Corporation), a brokerage firm, and various other defendants including The Fund of Funds, Ltd., which is a substantial shareholder of the Fund.

3. The Fund is a registered investment company under the Investment Company Act of 1940 ("the Act") having assets of approximately 110 million dollars. It has outstanding approximately 3,250,000 shares, each representing an equal interest in the Fund's total assets.

4. I have read the complaint and do not believe there is any merit to this action. The Certificate of Incorporation and By-Laws of the Fund provide in accordance with and subject to the limitations of the Business Corporation Law of New York that the directors, officers and employees of the Fund shall be reimbursed for their expenses, including legal fees, incurred in the defense of derivative shareholders' actions. All directors and a former director are named as defendants. I am advised that counsel will be retained by directors. Consequently, in addition to the

expense the Fund has already incurred, the Fund will immediately incur liability in substantial amounts to reimburse those officers and directors for expenses incurred by them.

5. The first paragraph of the complaint invokes "principles of pendent jurisdiction" and is said to be based "upon common law principles." I am advised by attorneys for the Fund that state law principles, in this case the law of New York where plaintiffs reside and the state of incorporation of the Fund, permeates the entire complaint. I am further advised that the purported federal claims are without merit and of dubious sufficiency. Thus, the only claim stated is in fact a New York claim, upon which a federal label has been attached.

6. The Fund is a "no-load" fund. That is, purchasers of shares pay no commission and acquire their shares at the net asset value per share. Shareholders may redeem at any time at the net asset value, without any payment of any commission or redemption charge. Since there are no salesmen earning commissions which cost the investor some 8% or 9%, the growth of the Fund depends upon its reputation for successful management. As hereinafter appears in detail, the growth by appreciation and by sale of additional sales reduces the advisory fee. Now that the Fund has crossed the $100,000,000 mark, the advisory fee on the asset value over that amount is only four tenths of one percent (0.4 of 1%), which is exactly half the rate of the advisory fee on the first $50,000,000. Thus, the continued growth of the value of the Fund's portfolio and the continued growth by sale of additional shares have the effect

of reducing the overall cost to shareholders of the investment advice furnished by the adviser.

7. The 50-odd shares held by the plaintiff out of the 3,250,000 outstanding have a fair value of no more than approximately $1,800 to $2,000, thus being a minute fraction of 1% of the Fund's outstanding shares and less than $50,000 in fair value. In view of the serious common law allegations in the complaint of violation of fiduciary duty attacking transactions involving millions of dollars, it will be necessary to conduct extensive preparation for trial, extensive discovery proceedings and to engage in a protracted law suit. Consequently, the expense to the Fund will be very heavy. The expense will be immediate, since the oral examination of a director and president of the Fund has already been noticed, even prior to joinder of issue. The expenses, including counsel fees, which the Fund will be required to pay and reimburse will also be heavy and will soon mount to at least $100,000 if the case proceeds as indicated. These heavy expenses are directly related to the "pendent jurisdiction" invoked in the complaint. I am advised that the narrow legal claims under federal labels are very much simpler to defend and litigate and will not require as heavy a financial burden to defend.

8. Since plaintiffs do not hold sufficient shares of the Fund to meet the standards of §627 of the Business Corporation Law, and since the Fund has already incurred expenses and will incur heavy expnse immediately, it is respectfully requested that the Court require the plaintiffs to furnish security in the amount of not less than One Hundred Thoustand Dollars ($100,000) pursuant to §627 of the Business Corporation Law.

Affidavit of John F. Newton Sworn to February 15, 1967 in Support of Motion

9. There are, in essence, three things complained of. The first is that the advisory fee is too high and is not related to the services performed by the investment adviser. Counsel have informed me that only three cases have been dcided on the merits out of the many cases which have been brought against mutual funds and their advisers, and all three cases have been determined in favor of the defendants and have applied state law, two of them in Delaware and the other by a federal court in Colorado which applied Delaware law and quoted extensively from the opinion of the Delaware Chancellor.

The second matter complained of asserts that there is domination and control of the Fund, claiming in one breath that a large Swiss stockholder, defendant The Fund of Funds, Ltd., controls the Fund, and claiming contrary-wise in another breath that the Fund is controlled by its adviser, Chestnutt Corporation.

The third purported claim relates to brokerage fees on portfolio transactions. It is not alleged that the Fund engaged in "churning", or was overcharged, or paid any brokerage fees other than the standard, customary and prescribed brokerage fees. Yet it is claimed that payment of brokerage fees constituted "conversion" and a "rebate", and various wrongful and even criminal labels are attached thereto.

10. The records of the Fund show that it commenced the year 1964 with net assets of $11,040,000. At that time this small, no-load Fund was paying a flat 1% per year advisory fee. During that year a new contract was entered into effective June 30, 1964, providing the following advisory fee schedule:

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Annual Rate	*Total New Asset Value*
0.8 %	First $50 million
0.6 %	Next $50 million
0.4 %	Next $100 million
0.3 %	Next $100 million
0.25%	Next $100 million
0.2 %	Next $100 million
0.15%	Next $500 million
0.10%	Excess of $1,000 million

This contract has been approved periodically by the Fund's shareholders including these individual plaintiffs who voted approval.

Since the Fund now has net assets of $110,000,000, it has now reached the third bracket of 0.4 of one percent, effecting an overall reduction in the cost to shareholders for the fee paid to the adviser.

No doubt the spectacular growth of this no-load Fund, not merchandised by persons seeking the customary 8% or 9% commission and not sold pursuant to "plans" with heavy "front-end loads", is due to the investment record of the Fund. For example in the year 1966, the net asset value per share (assuming re-investment of capital gain distributions) increased 3.0%, while the Dow Jones Industrial Average went down 18.9%. Thus, the investment adviser who is accused of performing services which "bear no relationship to the fees charged therefor," paragraph 5(i), was able in the chaotic markets of 1966 to perform services approximately 22% better than the Dow Jones Industrial Average referred to. Records in my possession show the Fund's increase in value per share from $10 per share in January of 1958 when the Fund made its first

investment to the end of the year, 1966. They show that (assuming re-investment of capital distributions) the value per share has increased 311.2%, whereas the Dow Jones Industrial Average has increased 75.6%. Thus, each shareholder of the Fund during the period has fared approximately 4 times as well as the Dow Jones Industrial Average.

I am advised by counsel that even if the Federal statute should be amended to create for the first time a federal standard of "reasonableness", as contrasted with the state standard, for the fees charged by investment advisers that the Securities and Exchange Commission has recommended that investment results be taken into account. As will be discussed more fully in the brief to be submitted in support of this motion, the Securities and Exchange Commission stated in a recent report to Congress (p. 145):

> "Thus the sustained investment performance of a company would be an appropriate consideration in evaluating the reasonableness of its advisers compensation."

The "sustained investment performance" of American Investors Fund, Inc. is shown by "Exhibit A" hereto, a four page supplement to "Investment Companies 1966" published by Arthur Wisenberger & Co. On the third page appears the fact that for the five-year period, 1962-1966, the appreciation per share of American Investors Fund was 145.3%, by far the best of all the funds listed.

Thus, even if Congress should create a federal body of law which for the first time would govern the fees paid to investment advisers, it is clear that the record of results would permit this no-load fund to continue the payment

of fees in accordance with the decreasing scale which the Fund has been paying.

Nevertheless, and without regard to the certainty of ultimate vindication in equity, in morals and at law, the defense of this action will require extensive and protracted preparation to meet charges of violation of state law. This will be very expensive to the Fund and to its directors whom the Fund is required to reimburse. I do not believe there is any relationship between this state claim and the other allegations in the complaint.

11. The second claim in the complaint, in the segment of allegations contained in paragraphs 6 through 11, does not relate in any way to the first claim that the advisory fee is unreasonable under state law. This second claim apparently seeks declaratory relief upon the bare assertion that a Swiss-based mutual fund dominates and controls the Fund. I am advised by counsel that even if the second claim were to be held to be sufficient under federal law, that nothing relating to the first claim would be relevant or material to prove this second claim. Since this motion is not directed to the sufficiency of the federal claims set forth in the second and third segments of the complaint, I simply want to deny plaintiffs' completely unfounded assertions.

I have inquired of other officers and directors of the Fund and its investment adviser and I am informed that at no time has there been any attempt made by The Fund of Funds to dominate or control the management or policy of the Fund. Only one new director, defendant Warren K. Greene, has joined the board of directors of the Fund since The Fund of Funds made its first purchase of shares in 1964. Mr. Greene was employed by the Fund's investment

adviser in January 1965, and he became a director of the Fund in 1966. From 1959 to 1965 Mr. Greene was employed by First Boston Corporation. He has advised me that he has had no connection or dealings whatever with The Fund of Funds or with any of its affiliates. The tenure of the other board members antedates by several years the first purchase of shares in American Investors Fund by The Fund of Funds.

The Fund's Certificate of Incorporation from its inception, some five years before The Fund of Funds commenced buying shares of the defendants' stock, has provided that if the Board of Directors determined that it was in the best interests of the remaining shareholders of American Investors Fund, it may pay a redemption in whole or in part in kind by distribution of securities from its portfolio. Thus, even if it were to be assumed that a substantial and concentrated shareholding could possibly influence the Fund by massive redemption or threatened massive redemption, the Fund is in a position where it may disregard any conceivable threatened influence with complete impunity and without the slightest risk, market or otherwise, to its remaining shareholders.

Moreover, The Fund of Funds has advised American Investors Fund that in keeping with its policy of not investing in any fund for the purpose of obtaining and exercising control that it has adopted a policy of voting shares in the same proportion that other shares are voted on particular issues, except 3%, which it reserves the right to vote in such manner as The Fund of Funds sees fit.

I do not know of any facts relevant or material to the first state law claim which have any bearing upon the asserted claim under federal law that the Fund is dominated by a foreign shareholder.

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12. The third claim asserts violations of federal law, with respect to brokerage commissions (paragraphs 12 through 20).

I do not understand how this claim involves the Fund, since the allegations relate to supposed relationships between The Fund of Funds and a brokerage firm.

Irrespective of what the facts may be, it is clear that the reasonableness of the advisory fee under state law does not involve the same facts as the relationships between The Fund of Funds and a brokerage firm.

13. In conclusion, it is clear to me as principal financial officer of the Fund that there will be an immense amount of work to do to prepare the defense of the alleged state claim. I know of no factual connection between the state claim and the two federal claims relating to foreign domination and brokerage. For the reasons set forth herein, I respectfully submit that the plaintiffs should be required to furnish security in the amount of $100,000, or in the alternative that the state claim be dismissed.

/s/ JOHN F. NEWTON
John F. Newton

Sworn to before me this 15th day of February 1967.

/s/ EDNA M. MILBERY
Notary Public

EDNA M. MILBERY
Notary Public, State of New York
No. 24-7982800
Certified in Kings County
Cert. filed with New York County
Term Expires March 30, 1968

Complaint

(Original)

UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF NEW YORK

67 Civ. 60

PLAINTIFFS DEMAND TRIAL BY JURY

ROSALIND FOGEL and GERALD FOGEL,

Plaintiffs,

—against—

GEORGE A. CHESTNUTT, JR., JOHN CURRIER, FRANK G. FOWLER, JR., WARREN K. GREENE, RICHARD W. RADCLIFFE, STANLEY L. SABEL, ELIZABETH SULLIVAN, FRANCIS L. VEEDER, AMERICAN INVESTORS CORPORATION, CHESTNUTT CORPORATION, THE FUND OF FUNDS, LTD., I.O.S., LTD. (S.A.), JESUP & LAMONT and AMERICAN INVESTORS FUND, INC.,

Defendants.

Plaintiffs, by their attorneys, Pomerantz Levy Haudek & Block, for their complaint, allege upon information and belief, except paragraph "2", which is alleged upon knowledge:

1. This action arises under the Investment Company Act of 1940, 15 U.S.C. §§ 80 a-1, et seq. (the "Act") and common law principles. The jurisdiction of the court is based on the Act and on the principles of pendent jurisdiction.

2. (a) Plaintiffs jointly are shareholders of defendant, American Investors Fund, Inc. (the "Fund") and have been shareholders since at least 1963 and at the times of the wrongs complained of herein.

(b) Plaintiffs bring this action derivatively on behalf of the Fund and representatively on behalf of themselves and all other shareholders of the Fund similarly situated.

(c) This action is not brought collusively to confer upon this court jurisdiction which it otherwise would not have.

3. The Fund is a New York corporation. It is and at all times relevant herein has been registered under the Act as a diversified open end management investment company.

4. (a) The individual defendants, other than Elizabeth Sullivan, comprise the Fund's board of directors. Elizabeth Sullivan has been a director of the Fund during the times of the wrongs complained of herein.

(b) In addition to their being directors of the Fund, defendant, George A. Chestnutt, Jr., is president of the Fund, defendant, Stanley L. Sabel, is vice-president and secretary of the Fund, and Elizabeth Sullivan has been, during the times of the wrongs complained of, treasurer of the Fund, and is presently assistant-treasurer of the Fund.

5. (a) Defendant, Chestnutt Corporation, a Connecticut corporation, is the successor in interest to American Investors Corporation, the investment adviser of the Fund. Defendant, George A. Chestnutt, Jr., is president, Treasurer and a director of Chestnutt Corporation and American Investors Corporation, and owns about forty-six (46%)

percent of the voting stock of each corporation. Defendant, Stanley L. Sabel, is vice-president, secretary and a director of Chestnutt Corporation and American Investors Corporation, and owns about sixteen (16%) percent of the voting stock of each. Defendant, John Currier, owns about two (2%) percent of the voting stock of Chestnutt Corporation and American Investors Corporation. Defendant, Elizabeth Sullivan, is assistant to the president of Chestnutt Corporation and American Investors Corporation.

(b) The Fund pays to Chestnutt Corporation, and has paid to American Investors Corporation, pursuant to investment advisory contracts, an annual advisory fee equal to .8% of the first $50,000,000 of net assets of the Fund; .6% on the next $50,000,000; .4% on the next $100,000,000; .3% on the next $100,000,000; .25% on the next $100,000,000; .2% on the next $100,000,000; .15% on the next $500,000,000, and .10% on all net assets in excess of $1,000,000,000.

(c) For the years ending December 31, 1963, 1964 and 1965, and the first six months of 1966, the Fund paid to American Investors Corporation investment advisory fees of $93,347.00, $187,083.00, $337,626.00 and $248,443.00, respectively.

(d) The huge increase in the amounts of the invesment advisory fee since 1963 has been due to the sharp rise in the net assets of the Fund. This rise has been due in large part to the sale of additional Fund shares to the public, which has provided substantially no benefits to the Fund and its shareholders. Despite the sharp rise in the amounts of the investment advisory fees, the expenses incurred by American Investors Corporation and Chestnutt Corporation in rendering investment advice and performing its

other management duties have remained substantially the same.

(e) Other managers and investment advisers did and do perform similar and more extensive duties for other investment companies at rates substantially below those charged by American Investors Corporation and Chestnutt Corporation to the Fund.

(f) The investment advisory fee paid by the Fund is one of the highest percentage fees paid by any open end investment company of which public information is available.

(g) The ratio of total operating expenses of the Fund to its average net assets (its "expense ratio") was approximately 1.2% in 1965, and was of similar magnitude in earlier years. It is grossly excessive and is one of the highest incurred by any investment company. It is far larger than the expense ratio of investment companies of comparable size to the Fund.

(h) In 1965 the operating expenses of the Fund consumed about sixty-six (66%) percent of the investment income of the Fund.

(i) The services performed by American Investors Corporation and Chestnutt Corporation for the Fund bear no relationship to the fees charged therefor.

6. (a) Defendant, The Fund of Funds, Ltd., a Canadian corporation, owns approximately thirty-six (36%) percent of the capital stock of the Fund.

(b) Defendant, The Fund of Funds, Ltd., is controlled by defendant, I.O.S., Ltd. (S.A.) ("IOS"), a Panama corporation, by reason of ownership by IOS of all of The Fund of Funds, Ltd.'s voting stock.

7. Defendants, John Currier, Frank G. Fowler, Jr., Warren K. Greene, Richard W. Radcliffe and Francis L. Veeder, obtained their positions with the Fund through the influence and action of defendants, Chestnutt, Sabel, American Investors Corporation, Chestnutt Corporation, The Fund of Funds, Ltd. and IOS and are beholden thereto for the substantial emoluments derived from their positions.

8. Chestnutt Corporation and American Investors Corporation are able to, and do, dominate and control the Fund and its personnel, its policies and its board of directors. By reason of such domination and control, § 10 (a) of the Act has been and continues to be violated.

9. By reason of the aforesaid domination and control the investment advisory contracts are and have been illegal and void and in violation of § 15 of the Act, and the payment of investment advisory fees thereunder is and has been illegal. Such shareholder approval of the investment advisory contracts as have been obtained has been procured through concealment of the aforesaid domination and control in violation of § 20 of the Act and is therefore void and of no effect.

10. The investment advisory fees paid by the Fund to American Investors Corporation and Chestnutt Corporation are excessive and constitute waste and spoliation of the Fund's assets in violation of the Act.

11. By reason of the aforesaid violations of the Act, the investment advisory fees paid by the Fund to American Investors Corporation and Chestnutt Corporation have been and are illegal.

12. The Fund of Funds, Ltd. and IOS are able to, and do, dominate and control the Fund and its personnel, its policies and its board of directors, with respect to the allocation of the Fund's brokerage.

13. As a result of the domination and control of the Fund by IOS, brokerage orders of the Fund have been and are placed at the request of IOS with the defendant, Jesup & Lamont, a New York partnership engaged in the securities business.

14. The basis for allocation of brokerage business to Jesup & Lamont was and is directly related to the size of the investment of The Fund of Funds, Ltd., in the Fund.

15. Commissions paid to Jesup & Lamont by the Fund were $111,142.00 in 1964 and $137,692.00 in 1965, and $29,184.00 in the first six months of 1966.

16. IOS and affiliated and related persons and organizations of IOS have derived substantial benefits from the Fund brokerage directed by IOS to Jesup & Lamont.

17. The aforesaid benefits include the following:

(i) Jesup & Lamont has furnished to IOS research, investment advisory and investment banking services, and Schroeder Boulton, a partner of Jesup & Lamont, has agreed to and has become a member of the board of directors of The York Fund, Inc., a registered investment company all the stock of which is owned by The Fund of Funds, Ltd. and the management company of which is controlled by IOS.

(ii) Mrs. Gloria Martica Clapp, the registered representative employee of Jesup & Lamont who is credited

by that firm with all commissions received by or given-up to the firm as a result of the designations made by IOS, has arranged for the deposit with Fiduciary Trust Company, Ltd., Nassau, the Bahamas (Fiduciary), of most of the amounts paid to her by Jesup & Lamont, as her share of the brokerage commissions on all business directed to it or give-ups paid to it at the request of IOS. Fiduciary, in turn, has transferred substantial sums of money to banks controlled by IOS or to banks which have material banking relationships with IOS.

(iii) Mrs. Clapp and her husband, Samuel F. Clapp, directly and indirectly through J. H. Crang & Co. (Nassau) Ltd., have assisted IOS in obtaining work entry permits for its salesmen, to permit them to sell the IOS Investment Program in Nassau, the Bahamas.

(iv) Samuel F. Clapp, directly and indirectly through Fiduciary and J. H. Crang & Co. (Nassau) Ltd., assisted in the procurement for IOS of subscribers to its IIT investment advisory service, "International Economic and Market Reports," at a subscription price of $2,500 per month ($30,000 per year) per subscription. These subscribers have paid to IOS substantially in excess of $100,000.

(v) Samuel F. Clapp has arranged for financial institutions to deposit more than $7,000,000 with banking institutions controlled by IOS or in which IOS has an interest.

(vi) Samuel F. Clapp, a member of the Bar of Massachusetts, directly and indirectly through Fiduciary, has provided IOS and its affiliated companies and persons with legal advice and a variety of other valuable services relating to the business affairs of IOS.

(vii) Samuel F. Clapp has introduced IOS, and caused IOS to be introduced, to persons with whom IOS or various of its subsidiaries have enjoyed valuable relationships.

18. As a result of such direction of brokerage, the Fund has been deprived of substantial benefits which otherwise would accrue to it.

19. The direction of brokerage commissions to Jesup & Lamont, as above-described, has constituted and continues to constitute a rebate to The Fund of Funds, Ltd., through its affiliate IOS, from the current public offering price of Fund shares in violation of § 22 of the Act.

20. The payment of such brokerage commissions to Jesup & Lamont has constituted and continues to constitute an unlawful and willful conversion by The Fund of Funds, Ltd., IOS, Jesup & Lamont and the individual director defendants of the monies, funds, property and assets of the Fund to the use of The Fund of Funds, Ltd., IOS and Jesup & Lamont, in violation of § 37 of the Act; and gross abuse of trust, gross misconduct, willful misfeasance, bad faith, gross negligence and a reckless disregard of their fiduciary duties by the Fund's officers and directors in violation of the duties which §§ 10, 17(h) and 36 of the Act impose upon them; and constitutes a waste and spoliation of the Fund's assets for the benefit and profit of IOS, The Fund of Funds, Ltd. and Jesup & Lamont, but to the harm and detriment of the Fund.

21. Demand upon the Fund's board of directors to bring this action would be futile and is unnecessary for at least the following reasons:

(a) The directors are defendants herein and participated or acquiesced in the wrongs alleged and are liable therefor;

(b) Defendants, American Investors Corporation, IOS and The Fund of Funds, Ltd., control and dominate the Fund and its board of directors; and

(c) The institution of the action by the Fund's directors would place it in hostile hands and would prevent its effective prosecution.

22. Demand upon the Fund's shareholders to bring this action would be futile and is unnecessary for at least the following reasons:

(a) The wrongdoings alleged herein violate the Act and are a waste of the Fund's assets and hence are incapable of shareholder ratification.

(b) Under New York law and under the charter and by-laws of the Fund, the management of its affairs, including the bringing of suits, is entrusted to the board of directors, not to the shareholders. The shareholders cannot by resolution or otherwise require the Fund or its board of directors to bring an action.

(c) Even if the shareholders were to direct the board of directors to bring this action, its control would lie in the hostile hands of the directors, who could not be entrusted with its effective prosecution.

(d) The Fund has many thousands of shareholders scattered all over the United States and foreign countries. Their identity is subject to frequent changes. To secure action from the shareholders would require a proxy fight with the management, which controls the proxy machinery of the Fund, and uses the Fund's moneys in preparing and mailing proxy material and soliciting the shareholders' votes. The conduct of a proxy fight by plaintiff would entail prohibitive expenses and would cause undue loss of time, with the danger that the claims alleged might become barred by the Statute of Limitations or laches.

WHEREFORE, plaintiffs pray for judgment:

(a) Declaring the contract employing Chestnutt Corporation as investment adviser of the Fund to be void;

(b) Enjoining defendants, temporarily and permanently, from continuing their unlawful conduct alleged herein;

(c) Requiring defendants other than the Fund to account for and pay to the Fund the advisory fees received by them since 1963;

(d) Requiring defendants other than the Fund to account for and pay to the Fund the brokerage commissions paid to Jesup & Lamont since 1963;

(e) Requiring the defendants other than the Fund jointly and severally to account for and pay to the Fund for their profits and gains and its losses;

(f) Awarding the plaintiffs the costs and expenses of this action including reasonable counsel fees; and

(g) Granting plaintiffs such other and further relief as may be just.

POMERANTZ LEVY HAUDEK & BLOCK

by /s/ ABRAHAM L. POMERANTZ
Member of Firm
Attorneys for Plaintiffs
Office & P. O. Address
295 Madison Avenue
Borough of Manhattan
City of New York 10017

STATE OF NEW YORK,
COUNTY OF NEW YORK, *ss.:*

ABRAHAM L. POMERANTZ, being duly sworn, deposes and says that he is a member of the firm of POMERANTZ LEVY HAUDEK & BLOCK, the attorneys for plaintiffs herein and has his office at 295 Madison Avenue, in the City of New York, County of New York; that he has read the foregoing complaint and knows the contents thereof and that the same is true of his own knowledge except as to matters therein stated to be alleged on information and belief, and that as to those matters he believes it to be true; that the reason why this verification is made by deponent instead of by plaintiffs is because plaintiffs are not within the County of New York, which is the county where deponent has his office. Deponent further says that the grounds of his belief as to all matters in said complaint not stated upon his knowledge are based upon his general investigation of the facts of this case.

/s/ ABRAHAM L. POMERANTZ
ABRAHAM L. POMERANTZ

Sworn to before me this
6th day of January, 1967.

DONNAGENE BURFIELD
Notary Public, State of New York
No. 24-5523665
Qualified in Kings County
Certificate filed in New York County
Commission Expires March 30, 1968

Amended Complaint

(First paragraph only, remanider of amended complaint identical to original complaint)

1. This action arises under the Investment Company Act of 1940, 15 U.S.C. §§ 80 a-1, et seq. (the "Act"). The jurisdiction of the court is based on the Act.

Memorandum Decision and Order of District Court

Rosalind Fogel and Gerald Fogel v. *George A. Chestnutt, Jr., et al.*, 67 Civ. 60, Civ. Mot. Cal. March 2, 1967 No. 51

Whether or not the amended complaint states a federal claim must, of course be determined on the face of the pleading, without regard to whether its allegations are true.

Brown v. *Bullock*, 294 F.2d 415 (2d Cir. 1961)

In my opinion, the allegations of the amended complaint with respect to the claimed illegality of the investment advisory contracts and the fees paid thereunder, contracts which are alleged to have been made as a result of the domination and control of the fund and its directors by the investment advisor, are sufficient to state a claim for violation of the Investment Company Act within the rule laid down in *Brown* v. *Bullock, supra.* It may be noted that since that case was decided in 1961, there has been a growing trend in favor of upholding federal jurisdiction in securities cases over claims which arguably could have been thought to charge merely a violation of state law. See *Brod* v. *Perlow*, Docket No. 31028 (2d Cir. March 27, 1967) which

involved Section 10(b) of the Securities Exchange Act of 1934.

Since the other claims alleged in the amended complaint are concededly federal, defendant is not entitled to a bond.

Fielding v. *Allen*, 181 F.2d 163 (2d Cir. 1950), *cert. denied*, 340 U.S. 817 (1950)

It also follows that the claims based upon the alleged illegality of the investment advisory contracts and the advisory fees should not be dismissed.

Motion denied.

So ordered.

Dated: March 30, 1967

EDWARD C. McLEAN
U. S. D. J.

Order of Affirmance of Court of Appeals

UNITED STATES COURT OF APPEALS

SECOND CIRCUIT

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Court House, in the City of New York, on the eighth day of May, one thousand nine hundred and sixty-seven.

Present:

HON. J. JOSEPH SMITH,
HON. IRVING R. KAUFMAN,
HON. PAUL R. HAYS,
Circuit Judges.

ROSALIND FOGEL and GERALD FOGEL,
Plaintiffs-Appellees,

—v.—

GEORGE A. CHESTNUTT, JR., *et al.*,
Defendants-Appellants.

A motion having been made herein by counsel for the appellees to dismiss the appeal for lack of jurisdiction or to summarily affirm the order of the District Court,

Upon consideration thereof, it is

Order of Affirmance of Court of Appeals

Ordered that said motion to dismiss be and it hereby is denied.

Further ordered that the order of the United States District Court for the Southern District of New York be and it hereby is affirmed with costs to the appellees.

A. DANIEL FUSARO
Clerk